NCN: [2024] UKFTT 00299 (TC)

Case Number: TC09128

FIRST-TIER TRIBUNAL
TAX CHAMBER

By remote video hearing

Appeal Reference: TC/2021/02742
TC/2021/02744

PROCEDURE – MUCs – significant volume of evidence - application by HMRC for a direction to use sampling method – whether evidence served on Appellants should be limited

Heard on: 1 February 2023
Judgment date: 09 March 2023

Before

TRIBUNAL JUDGE JENNIFER DEAN

Between

EZY SOLUTIONS LTD (in liquidation)
MILO CORPORATION LTD (in liquidation)

Appellants

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Mr D. Bedenham, Counsel

For the Respondents: Ms J. Goldring of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION ON PRELIMINARY APPLICATION

INTRODUCTION

1. These joined appeals concern VAT assessments, denials of the right to deduct under *Kittel* and section 69C penalties.

2. In brief, Ezy Solutions Ltd ("ESL") and Milo Corporation Ltd ("Milo") were payroll and labour providers supplying temporary workers to recruitment agencies. ESL was also a main customer of Milo. The workers were employees of mini umbrella companies ("MUCs"). ESL performed the payroll on behalf of the recruitment agencies and its associated business Ezy Payment Solutions Ltd paid the workers and the VAT liabilities of the MUCs.

3. HMRC contend that the scheme operated by ESL purchasing labour from Milo which in turn purchased from a network of approximately 1050 allegedly unconnected VAT MUCs which in turn purchased that labour from a network of approximately 8000 allegedly unconnected PAYE MUCs. The workers were employed by the PAYE MUCs. Milo sold that labour to ESL which in turn supplied employment agencies and hirers of temporary labour which then sold that labour to the end users. There were 6 entities in the supply chain between worker and end user.

4. HMRC contend that a supply chain of such length was not commercially feasible and the VAT MUCs which supplied Milo fraudulently defaulted on their VAT obligations, principally by abusing the VAT Flat Rate Scheme ("FRS") by claiming to trade in the wholesaling/printing/associations trade classification and accounting for VAT at a rate of (in most cases) 8 – 8.5% which they were not entitled to, and by failing to pay VAT charged by them and due from them.

APPLICATION

5. HMRC applied for a direction from the Tribunal in the following terms:

> "Noting that the appeals concern supplies of labour involving approximately 1050 VAT MUCs, the Respondents and the Appellants seek to agree, by 2 May 2023 a representative sample of those supplies from the VAT MUCs relevant to these proceedings. This sample (along with the wider evidence) is to be determinative of the appeal as a whole. The parties' evidence before the Tribunal shall therefore, with regard to the VAT MUCs, be limited to evidence in relation to the agreed sample alongside the MUC schedule."

6. HMRC clarified that the number of VAT MUCs is subject to change and an application to amend the Statement of Case will be made once HMRC's evidence has been served. The number is likely to decrease to approximately 600 or 700.

7. HMRC proposed a sample of 50 VAT MUCs.

8. Having filed the Consolidated Statement of Case on 30 May 2022, HMRC contacted the Appellant to suggest that directions be agreed regarding sampling.

9. On behalf of the Appellants, Joseph Hage Aaronson responded on 16 June 2022 to say that a representative sample could not be agreed until all of the evidence in relation to the MUCs had been served as the Appellant would not be in a position to know whether the sample was representative. Draft directions were proposed.

10. On 20 June 2022 HMRC confirmed that they could not agree the Appellant's proposed directions as this would entail serving the evidence to prove the VAT loss for all MUCs which would take "an inordinate amount of time". The application was therefore listed for a case management hearing to determine the application.

HMRC'S ARGUMENTS

11. Ms Goldring argued that it would be disproportionate to require HMRC to collate and serve the underlying evidence used to populate the MUC schedule. I was taken to the schedule and an example of the underlying documents in relation to two of the MUCs listed thereon which included VAT registration, Companies House details, the VAT 1, VAT return data and Milo's declarations.

12. Proving the VAT loss and fraudulent default would be a lengthy task and would require evidence of the respective VAT accounts for each VAT MUC and cross-referencing to the Second Appellant's transactions for each VAT MUC.

13. A trial of the evidence of approximately 700 VAT MUCs would be unmanageable by reference to the volume of documentation, use a disproportionate amount of the Tribunal's time and resources, lead to parties incurring excessive costs and substantially delay a determination of the issues.

14. HMRC accept that it is required to prove the tax loss but noted that *Kittel* makes no restrictions on how this can be done. Ms Goldring submitted that sampling provides an alternative and proportionate response in accordance with the over-riding objective.

15. Ms Goldring clarified that the best judgment assessments were reached, as I understand it, by looking at the percentage of nil or no returns. The average tax loss for those nil returns was approximately £34,000. The officer then looked at other periods, the number of MUCs and applied the percentage. The number of MUCs was then multiplied by the tax loss. Ms Goldring accepted that it was not clear from the MUC schedule relied on by HMRC which companies had nil returns and that the Appellant is entitled to more details, however this is not required in order to choose a sample. Sampling will not affect the issue of best judgment and the officer can be cross-examined on the issue. Best judgment was used due to the lack of records available.

16. Ms Goldring accepted that Article 6 is engaged but noted that these are not criminal proceedings and Article 6 does not fetter the Tribunal's case management powers. Sampling would not breach the Appellants' Article 6 rights and they will have all the protection which is inherent in the hearing process such as cross-examination.

ARGUMENTS FOR THE APPELLANTS

17. Mr Bedenham explained that before the Appellants can reach an informed view on a representative sample, the Appellants need to see the evidence in relation to each purchase on which input tax has been denied. On review of the evidence the Appellants may challenge whether HMRC can establish a tax loss and/or fraud in relation to all or some of the alleged fraudulent defaulters. It may also be that some of the purchases do not share common features with others such as to mean that they cannot adequately be considered by way of a representative sample approach.

18. HMRC ought to have the evidence available given that it reached a conclusion on the issue of fraudulent default in relation to each purchase. The decision was made in November 2020.

19. This is a *Kittel* case and HMRC are required to prove the tax loss they rely on to justify the input denials. Mr Bedenham noted that HMRC have indicated that they intend to make a significant amendment to their pleaded case, and it therefore appears that they have asked not only for a representative sample to be chosen before their evidence is served but also before they have even ascertained the total number of alleged defaulters. This is nonsensical and does not further the overriding objective.

20. The consequence of HMRC's proposal would be that the Tribunal would be asked to make a finding of fraud against 1,000 companies despite there being no evidence before the Tribunal in relation to those companies and despite the Appellant never having seen the evidence. The Tribunal would be also asked to make a finding that the Appellants knew or should have known that purchases from the 1,000 companies were connected with fraud despite there being no evidence before the Tribunal in relation to the Appellants' purchases from those companies despite the Appellant never having seen the evidence.

21. The decision letters did not list any transactions but simply stated the relevant VAT periods and the amount of input tax denied in each period. The penalty letters stated:

> "the penalty to be raised for [EZY/Milo] is based on the VAT tax losses of Mini Umbrella Companies (MUC) which supplied labour to Milo Corporation…These companies calculated their VAT returns using the VAT Flat Rate Scheme. Many of them filed a Nil VAT return, stating no sales were made, or filed no VAT return at all. The tax loss is the difference between what was declared under the VAT Flat Rate Scheme and what should have been declared using the standard rate of VAT and the amount claimed in respect of the Nil declarations and missing returns."

22. In correspondence HMRC explained that how the denied input tax had been calculated for periods 02/19, 05/19, 08/19 and 11/19. In relation to the other VAT periods HMRC simply stated that this was based on "best judgment" following a review of a representative sample of the Appellant's purchases. It therefore appears that HMRC are inviting the Tribunal to determine the case by reference to a sample of a sample. Furthermore, it appears the officer extrapolated even where documents were available and there was no need to use best judgment.

23. HMRC contend that there is commonality between the VAT MUCs. This is no more than an assertion set out in a schedule; HMRC need to provide evidence in order for the Appellants to assess whether it wishes to challenge aspects of HMRC's case such as this. Assertions and schedules are not evidence, and the Appellants have no way to know if they are accurate.

24. Article 6 issues arise in respect of the s69C penalty, and it must be noted that the value of the appeals is approximately £50m. On any view this is significant litigation and in such circumstances the Appellants cannot be deprived of the right to assess the evidence. At this stage the Appellants are unfairly disadvantaged, and it is a fundamental right to see the evidence irrespective of whether that causes a significant amount of work.

AUTHORITIES

25. The parties referred me to the following authorities which I considered in reaching this decision:

(i) *Revenue & Customs v Sunico A/S & Ors* [2013] EWHC 941 (Ch)

(ii) *Megantic Services Ltd v Revenue & Customs* [2015] UKFTT 120 (TC)

(iii) *Impact Contracting Solutions Ltd v The Commissioners for HM Revenue and Customs* [2019] UKFTT 646 (TC)

(iv) *Gafgen v Germany* (1 June 2010, No 22978/05)

(v) *Euro Wines (C&C) Ltd v HMRC* [2018] EWCA Civ 46

DECISION

26. There was no dispute between the parties that the Tribunal has a wide discretion in its case management powers. Rule 2 and 5 of the FTT Rules provide:

Overriding objective and parties' obligation to co-operate with the Tribunal
2.—(1) The overriding objective of these Rules is to enable the Tribunal to deal with cases fairly and justly.
(2) Dealing with a case fairly and justly includes—
(a)dealing with the case in ways which are proportionate to the importance of the case, the complexity of the issues, the anticipated costs and the resources of the parties;
(b)avoiding unnecessary formality and seeking flexibility in the proceedings;
(c)ensuring, so far as practicable, that the parties are able to participate fully in the proceedings;
(d)using any special expertise of the Tribunal effectively; and
(e)avoiding delay, so far as compatible with proper consideration of the issues.
(3) The Tribunal must seek to give effect to the overriding objective when it—
(a)exercises any power under these Rules; or
(b)interprets any rule or practice direction.
(4) Parties must—
(a)help the Tribunal to further the overriding objective; and
(b)co-operate with the Tribunal generally.

Case management powers
5.—(1) Subject to the provisions of the 2007 Act and any other enactment, the Tribunal may regulate its own procedure.
(2) The Tribunal may give a direction in relation to the conduct or disposal of proceedings at any time, including a direction amending, suspending or setting aside an earlier direction.
(3) In particular, and without restricting the general powers in paragraphs (1) and (2), the Tribunal may by direction—
(a)extend or shorten the time for complying with any rule, practice direction or direction, unless such extension or shortening would conflict with a provision of another enactment setting down a time limit;
(b)consolidate or hear together two or more sets of proceedings or parts of proceedings raising common issues, or treat a case as a lead case (whether in accordance with rule 18 (lead cases) or otherwise);
(c)permit or require a party to amend a document;
(d)permit or require a party or another person to provide documents, information or submissions to the Tribunal or a party;
(e)deal with an issue in the proceedings as a preliminary issue;
(f)hold a hearing to consider any matter, including a case management hearing;
(g)decide the form of any hearing;
(h)adjourn or postpone a hearing;
(i)require a party to produce a bundle for a hearing;
(j)stay (or, in Scotland, sist) proceedings;
(k)transfer proceedings to another tribunal if that other tribunal has jurisdiction in relation to the proceedings and, because of a change of circumstances since the proceedings were started—
(i)the Tribunal no longer has jurisdiction in relation to the proceedings; or
(ii)the Tribunal considers that the other tribunal is a more appropriate forum for the determination of the case;
(l)suspend the effect of its own decision pending the determination by the Tribunal or the Upper Tribunal, as the case may be, of an application for permission to appeal, a review or an appeal.

27. This case is clearly substantial both in the amounts involved and complexity. In reaching my decision I have considered how any legal or factual challenge to issues of tax loss and connection to fraud can best be addressed in accordance with the overriding

objective to deal with cases fairly and justly which, as set out above, includes dealing with the case in a proportionate manner.

28. I am grateful to the parties for providing written submissions following the hearing on a case management decision of Judge Berner which was not included in the bundle, and which was not reported, but which was referred to in *Megantic Services Ltd v Revenue & Customs* [2015] UKFTT 120 (TC) (see [11] above) and which, although not binding on me, I considered may have some relevance as it addressed the issues of sampling and general case management in cases involving substantial documentation; *Megantic Services Ltd v The Commissioners for HM Revenue and Customs* (16 February 2011) ("*Megantic*").

29. Ms Goldring highlighted the distinction with *Megantic* on the basis that HMRC in this case are not in possession of underlying documents such as invoices and purchase orders between the VAT MUCs and Milo. It intends to prove the tax loss by means of a VAT MUC schedule and the underlying evidence for a sample of 50 of those transactions using the type of documents referred to at [11] above. The MUC Schedule is akin to the deal sheets served in MTIC Kittel cases.

30. HMRC highlighted that *Megantic* supports the proposition that sampling is not unlawful, and any concerns of unfairness is addressed by the Appellant's involvement in ensuring that representative samples are used. Ms Goldring accepts that it appears that some evidence underlying the deal chains in *Megantic* was served in advance of the sampling decision but argues that it is by no means clear from the decision that all evidence was served (relying on [6] and [17] of the decision).

31. Mr Bedenham submitted that the clear indication from Judge Berner's decision is that the underlying evidence was served by HMRC on *Megantic* prior to a decision in relation to sampling being taken by the Tribunal (see [6], [9], [10], [11] and [13]).

32. In my view, it is clear that in *Megantic* the majority, if not all of evidence had been served at the time sampling was proposed. Judge Berner had previously issued directions which required, "…in respect of each deal chain, a description of the documentary evidence (if any) on which the Respondents seek to rely in proving the connection to fraud…cross-referenced to that documentary evidence…disclosed to the Appellant…" (see [6]). The decision goes on to refer to evidence served and other evidence that "will be relied upon to establish the integrity of the deal chains". However, it seems to me that in referring (at [17]) to the evidence that would be adduced in respect of the sampling method proposed, HMRC were referring to the evidence on which they intended to rely before the Tribunal, not that which had not been served on the Appellant. The fact that the decision recognises that the Appellant challenged the connection to fraud and refers to "particular deals with respect to which the Appellant has raised an issue" see [18]) implies that the Respondents' evidence had been disclosed to the Appellant. Similarly, the fact that the Appellant was in a position to challenge whether the samples proposed were representative further indicates to me that the Appellant was in possession of sufficient evidence to enable it to do so.

33. I note that the issue in *Impact Contracting Solutions* concerned expediting the hearing of the appeal; the issue of sampling was referenced only in passing and the parties' both agreed with the proposal. There is no indication relating to the amount of evidence that had been served or would be served prior to the parties agreeing a representative sample.

34. I found *Sunico* of limited assistance; it was not a *Kittel* case, and the sampling was relevant to whether a conspiracy could be proved which was sufficient for the claim to succeed. In this case, the relevant limbs of test laid down in *Kittel* must be met which requires HMRC to proves a tax loss and connection to fraud (together with actual/constructive knowledge) in respect of each denied purchase.

35. Having considered the authorities to which I was referred, I consider that while it may be that sampling in this appeal is an appropriate method by which to manage the issues and evidence in due course, this application is premature.

36. In *Megantic*, Judge Berner's conclusions that sampling causes no unfairness was predicated on the basis that "the sample must be representative". I agree. However, at this stage, the Appellants are in possession of no more than the MUC schedule which, as submitted by Mr Bedenham, is no more than an assertion. As described by Judge Berner in *Megantic* such documents are "mere constructs of the Respondents" and "it will be the evidence itself which either established the accuracy or otherwise of a deal sheet".

37. At present, the Appellants are unable to check the accuracy of HMRC's assertions and I do not see how, in those circumstances, the Appellants' representatives can be expected to carry out their profession duties to their clients. Whilst I agree that sampling is, where appropriate, an efficient method by which to keep evidence within sensible bounds, it is not a course which envisages depriving the Appellant of the evidence or knowing the case it must meet.

38. It is a fundamental principle of natural justice that a party must know the case against it. I cannot see how in circumstances where HMRC propose not to serve the evidence which formed the basis of its decisions, the Appellants could form a view as to whether any sample is representative or whether there is commonality.

39. The FTT rules recognise the importance of parties to be able to participate fully in proceedings. If HMRC's proposal is adopted at this early stage, I consider that the Appellant would be disadvantaged and unable to do so.

40. In due course, once the underlying evidence is served, the Appellants may or may not agree the accuracy of the MUC schedule. The tax loss and/or connection to fraud may or may not be challenged. They may or may not agree that sampling is appropriate. However, as things stand, the Appellant simply does not have the underlying evidence upon which HMRC's decisions are based to make an informed view on any issue.

41. The burden of proof in this case rests with HMRC. Many appeals which involve decisions relying on *Kittel* are substantial in volume. I do not consider it a sufficient reason for HMRC to argue that serving its evidence would take "an inordinate amount of time". Given that HMRC reached its decision in 2020 the evidence must be readily available to it. No doubt the Appellants' review of the evidence will be equally as onerous, but that is the nature of such cases. I do not accept that it is disproportionate to require the evidence upon which HMRC have raised assessments and imposed penalties amounting to approximately £50m to be served. In the context of these joined appeals I take the view that this is an unavoidable consequence of the large volume of evidence generated by case of this nature.

42. For the reasons set out above I refuse the application at this stage.

43. If required, the parties must file with the Tribunal agreed directions for the future progress of this case within 28 days.

ANCILLARY MATTER

44. Following HMRC's submissions and a brief overview of its case in relation to best judgment, Mr Bedenham made an application to amend the Appellants grounds of appeal. Having considered the decision letters and documents to which I was referred, I agree that there has been little provided to the Appellants by way of explanation in relation to the basis of the best judgment assessments. Given the early stage of proceedings I see no prejudice to HMRC in granting the application. However, I have not had the benefit of representations from HMRC and in those circumstances I direct as follows:

(1) Unless any objection is received within 7 days the Appellant is granted permission to amend the grounds of appeal in the terms sought as follows:

"Further, the assessments issued by HMRC were not to best judgment"

(2) If HMRC object to the amendment, full particulars of the objection must be provided.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

45. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

JENNIFER DEAN

TRIBUNAL JUDGE

RELEASE DATE: 09th MARCH 2023